

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House
(317) 232-9855

FISCAL IMPACT STATEMENT

LS 6034

BILL NUMBER: SB 14

DATE PREPARED: Oct 21, 2001

BILL AMENDED:

SUBJECT: Inheritance Tax Exemption for Class A Transferees.

FISCAL ANALYST: Jim Landers

PHONE NUMBER: 232-9869

**FUNDS AFFECTED: X GENERAL
DEDICATED
FEDERAL**

IMPACT: State & Local

Summary of Legislation: The bill provides a complete exemption from the Inheritance Tax for property interests transferred to lineal descendants and ancestors (Class A transferees) with respect to persons who die after June 30, 2002.

Effective Date: July 1, 2002.

Explanation of State Expenditures: The bill could potentially result in reductions in the amount of resident Inheritance Tax revenue retained by the counties. The revenue loss to counties is estimated to be approximately \$4.5 M statewide for FY 2004. This is based on the Revenue Technical Committee's FY 2003 forecast (April 12, 2001) for the Inheritance Tax and assumes that revenue will remain the same in FY 2004. The estimate will be updated once the FY 2004 forecast is available. As a result of the revenue loss, the bill could potentially increase expenditures from the state General Fund relating to the Inheritance Tax replacement for counties. The impact on the state General Fund may not equal the revenue loss to the counties since most are retaining more revenue than is guaranteed under the replacement procedure. The net impact of the bill reflected in the table below assumes that the revenue loss to the counties will be fully reimbursed by the state. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the impact that the bill may have on county replacement is not expected to begin until FY 2004. (See Explanation of Local Revenues, below, for further explanation of the replacement procedure.)

Explanation of State Revenues: The bill could potentially lead to a reduction in revenue from the Inheritance Tax and an increase in revenue from the Estate Tax. The bill is expected to reduce Inheritance Tax revenue by an estimated \$51.9 M in FY 2004. Also, the bill is expected to increase Estate Tax revenue by about \$28.7 M in FY 2004. These estimates are based on the Revenue Technical Committee's updated FY 2003 forecast for the Inheritance and Estate Taxes. They assume that Inheritance Tax revenue will remain the same in FY 2004 but make adjustments to forecasted Estate Taxes to account for the elimination of the

Indiana Estate Tax in concert with the repeal of the state death tax credit under the federal Estate Tax. These estimates will be updated once the FY 2004 forecast is available. The net impact of the bill is summarized in the table below. The estimated net revenue loss is approximately \$23.2 M in FY 2004. The impact of state expenditures on county replacement, increases the loss to the state (net revenue loss plus county replacement expenditures) to approximately \$27.7 M in FY 2004. It is important to note that the net loss will increase thereafter as the offset from the Indiana Estate Tax declines due to increases in the federal unified credit and the phase-out of the federal state death tax credit. This offset will decline to zero in FY 2007.

STATE IMPACT	FY 2004
Inheritance Tax Revenues	(\$51.9 M)
Estate Tax Revenues	\$28.7 M
State Expenditures for County Replacement	(\$4.5 M)
Net Increase (Decrease)	(\$27.7 M)

Background on Inheritance Tax: The bill would completely exempt transfers to Class A transferees from the Inheritance Tax. The change would be with respect to transfers made by persons who die on or after July 1, 2002. Since the Inheritance Tax does not have to be paid until a maximum of 12 months after the decedent's death (within 9 months of the date of death to receive the 5% early payment discount), the full impact of the bill likely would not be experienced until FY 2004.

The estimated impact of this change is based on an Office of Fiscal and Management Analysis (OFMA) database consisting of Inheritance Tax returns relating to a decedent who died between July 1, 1997, and June 30, 2000. The database consists of 112,951 transferee records. It is assumed that the sample is representative of the universe of persons paying the Inheritance Tax. Of the total tax liability for the sample, 39.43% is attributable to Class A transferees, 35.35% is attributable to Class B transferees, and 25.22% is attributable to Class C transferees. The estimated revenue loss is based on the Revenue Technical Committee's updated FY 2003 forecast for the Inheritance Tax equal to \$160 M and assumes that revenue in FY 2004 will remain the same. The forecast total includes revenue from the Indiana Estate Tax. Based on FY 2001 collections, roughly 17.7% of this total is derived from the Estate Tax. This suggests that Inheritance Tax revenue is forecast at approximately \$131.7 M and Estate Tax revenue at \$28.3 M. The estimated tax liability attributable to Class A transferees is, therefore, approximately \$51.9 M.

Background on Estate Tax: Although the bill does not make changes to the Indiana Estate Tax, the reduction in Inheritance Tax liabilities for Class A transferees could potentially have an impact on Estate Tax revenues. Indiana Estate Tax is owed on the assets of an estate if (1) federal Estate Tax is owed on the estate and (2) the Indiana portion of the state death tax credit for federal estate tax purposes exceeds the total Inheritance Tax paid by transferees of the estate. Consequently, for some estates a reduction in the Inheritance Tax liability paid by transferees of the estate results in a compensating increase in the Estate Tax liability.

The estimated impact of the bill on Estate Tax revenues is based on an OFMA database of Estate Tax returns relating to decedents who died between July 1, 1997, and June 30, 2000. The database consists of 559 estates upon which Indiana Estate Tax was paid. The Inheritance Tax changes provided for in the bill increased the Estate Tax liability of the sample by a factor of approximately 4.6. The forecast for the Estate Tax, adjusted to account for recent federal Estate Tax changes, is equal to about \$7.97 M for FY 2004. The recent federal

law changes accelerate the scheduled increase in the unified credit and begin phasing out the state death tax credit in 2002. As a result, the Inheritance Tax changes are estimated to increase expected Estate Tax revenue in FY 2004 by roughly \$28.7 M.

Explanation of Local Expenditures:

Explanation of Local Revenues: Counties retain 8% of the Inheritance Tax collected on transfers made by Indiana residents. The revenue loss to counties is estimated to be approximately \$4.5 M statewide. This is based on the Revenue Technical Committee's updated FY 2003 forecast for the Inheritance Tax and assumes that revenue will remain the same in FY 2004. The estimate will be updated once the FY 2004 forecast is available. It is important to note that a reduction in the amount of Inheritance Tax retained by counties due to the bill may be reimbursed by the state under the replacement provision established by P.L. 254-1997. The replacement provision was established when the Class A exemption was increased on July 1, 1997. The replacement provision guarantees that in each fiscal year each county receives an amount under the Inheritance Tax that is equal to the five-year annual average amount of Inheritance Tax revenue retained by that county from FY 1991 to FY 1997, excluding the highest and lowest year. Therefore, a reduction in tax retained by a county due to the bill would be reimbursed only to the extent that the changes made by the bill cause the amount of tax revenue retained by the county to fall below its guaranteed amount. Currently, most counties are retaining more Inheritance Tax revenue than is guaranteed under the replacement procedure.

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties.

Information Sources: State Revenue Forecast, April 12, 2001. Bill Reynolds, Indiana Department of State Revenue, 232-2075. OFMA Inheritance and Estate Tax Databases.